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**Two new Chinese steel groups emerge**

Small mills join forces as market continues to slide: page 15

# Metal Bulletin

**TO THE RESCUE**

## Russia's mission to revive ailing Al market



Russia seeks support for co-ordinated production cuts from China as SRB launches buying spree to prop up beleaguered aluminium market. MB examines the potential benefits and possible pitfalls of such measures: page 4 & 5

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# Metal Bulletin

## Down and out down under?

When OZ Minerals was created early last year by combining Zinifex and Oxiana, it was heralded as a significant new diversified miner.

With assets across the base and precious metals spectrum, it looked a good bet to become at least a strong mid-tier player in Australia and beyond.

But, even more than other Western Australia miners, it has been caught out by the financial crisis.

Its share price has been wiped out, it is struggling to refinance debt and it is willing to sell its best assets to remain afloat.

The extra two months granted to OZ last week to secure new cash flow is a reprieve, nothing more.

Managing director and ceo Andrew Michelmore said the company "remains very focused" on securing this new funding and negotiations had made "considerable progress".

But last week's statement also said quite bluntly: "There is necessarily some uncertainty as to whether refinancing can be achieved" even by the extended date. In the long run, OZ may end up being dismembered.

For now, at least some asset sales are definitely on the cards, so the question is: what can they sell and to whom?

The company itself says that all assets are potentially up for grabs, but it seems to be pushing the Prominent Hill copper-gold mine more than any other.

The Avebury nickel mine has been mothballed because of low nickel prices, so is hardly likely to fetch a good price or attract much interest.

The Century zinc mine is a substantial asset but, with zinc prices where they are, OZ has been waging a battle to keep it open.

The mines in Laos may be attractive but are hardly likely to raise the kind of money required by OZ.

The fact is that Prominent Hill is the best option to sell in these desperate times because it is the best asset.

"They need as much cash as possible upfront, and they need it as quickly as possible," said one source in the Australian metals sector.

Given the state of financial markets, it looks like the buyer would need to be a larger company – Xstrata, Anglo American, Rio Tinto and BHP Billiton have all been mentioned.

Rio is attending to its own "housekeeping" problems at the moment as it tries to deal with the debt raised to buy Alcan.

BHP, by contrast, is probably itching to buy something else after failing to snag Rio Tinto.

But the Chinese will also be keen to have a look. Their smelters are desperate to secure overseas raw materials supplies, they have state backing and Australia has proved reasonably open to foreign investments of this size in the past.

Chinalco, the owner of a minority stake in Rio Tinto, might like to consider Prominent Hill as it diversifies from aluminium into copper and other metals.

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# World steel in 2009

The leading lights of the iron and steel industry give their predictions for the next twelve months

## Riding out the storm

Aditya Mittal  
CFO ArcelorMittal



The steel industry is confronted by a recession the speed and severity of which has not been seen for decades. While some demand deterioration can be expected in 2009, past downturns suggest that a significant portion of the demand destruction is now behind us.

Compared with previous crises, the industry is in a much stronger position due to its improved

fundamentals. Consolidation has occurred in the industry and steelmakers have reacted decisively and aggressively to adapt supply to demand in recent months.

ArcelorMittal has taken the following steps:

- We have accelerated production cuts to run at less than 65% capacity utilisation rate without sacrificing market share as the de-stocking phase begins to conclude
- We have recently announced a management gains plan in order to reinforce our cost leadership (\$4 billion)
- We have increased this target focusing on SG&A (\$1 billion additional)

With around 1.5 billion people experiencing or on the brink of industrialisation, steel demand will rebound moving forward. With a significant proportion of our production in high-growth emerging markets the long-term prospects for recovery in steel demand remain sound.

## Time to seize opportunities

Rod Beddows  
CEO, Hatch Corporate Finance

Looking back five years from now what will we see as the major events for the steel sector in 2009?

The steel sector may see a major transformation in its commercial relationships through the entire value chain from iron ore and scrap processors to the 5 million end-users who buy steel across the world.

Current market turbulence highlights more than ever the issue of risk management in prices, volumes and contractual relationships throughout the value chain.

Producers and consumers have been caught with over-valued inventories and stocks as prices declined, they have cut production by 30-50% in different regions of the world and these factors will have a dramatic negative impact on cash flows and balance sheets.

But the aluminium industry, together with some other competing materials, is in a fundamentally different and more easily managed position.

Aluminium production has been scaled back only 8% so far. The inherent difficulties of idling pot lines are equivalent in difficulty and cost to idling blast furnaces.

But volumes do not have to be cut urgently as much has been sold forward at prices prevalent for aluminium on the London Metal Exchange six to nine months ago.

Cash flows for these producers are therefore protected over the short to medium term while they can organise themselves for a longer term response to current market conditions.

The choice to do this is up to themselves.

The conditions of the two industries are fundamentally different due to the existence of various price risk management mechanisms.

Starting at the turn of this decade, I and my colleagues at Hatch Beddows offered the prognosis that there were three conditions

required for the steel industry to be systemically and sustainably profitable: to progress privatisation; to achieve a substantial degree of consolidation; and for there to be price risk management mechanisms such as futures, forward contracts, swaps and so on. We still believe this to be the case.

Over the last two or three years there has been a rapid growth in over the counter (OTC) contracts. BHP Billiton is pushing to end the benchmark system for iron ore and move to spot or index prices, just as in thermal coal.

The LME is offering regional forward contracts on steel billets which are gaining liquidity. CME/Nymex has launched a futures contract on hot rolled coil for North America.

The principles have been established and even some of the most vocal opponents of steel contracts are working behind the scenes on such instruments for the benefit of the whole value chain.

So 2009 could see an explosion in the use of these price risk management mechanisms and the establishment of some successful contracts.

Was it Eisenhower who said "never miss the opportunity presented by a crisis"? Let's see if the steel sector seizes the opportunity presented by the current chaos in 2009.

## Uncharted territory

Jim Lennon  
Senior Analyst, Macquarie Capital Securities

After six consecutive yearly rises totalling almost 400%, fines prices are certain to fall due to the major collapse in demand.

The consensus is for a 20-50% fall in benchmark fines prices. There should be a proportionately bigger falls in lump and pellet prices.

Lump and pellet premiums are at record highs and in the light of the demand collapse look way too generous, notwithstanding recent major pellet production cuts.

The biggest uncertainty in 2009 is

the pricing mechanism itself.

Commitment to a single annual benchmark price set from April 1 and then followed by all market participants unquestioningly appears to be waning.

In 2008, Brazilian and Australian suppliers set different benchmark prices in Asia and then there was an abortive attempt by Vale to enforce a mid-stream benchmark price adjustment.

BHP Billiton is supporting moves towards what it sees as a more transparent pricing mechanism that is determined at the point of consumption (cfr) and reflects freight differentials (the current benchmark is fob).

BHP Billiton says it will not sign another long term volume contract based on traditional benchmark prices. Vale is more committed to the benchmark system but has indicated that it would change if its customers desire.

Since 2003, a significant spot market for iron ore has emerged, now accounting for 35-40% of all iron ore used in China.

A serious attempt at standardisation is currently under way with published normalised index prices for spot imported iron ore.

Some hope that these will be used as a credible independent reference by spot and long-term contract participants alike, thereby avoiding the often acrimonious annual benchmark negotiations.

Some banks are quoting forwards prices based on these indexes, hoping to generate a liquid paper market to enable participants to hedge their exposures.

Recent calls have been made by some buyers to backdate benchmarks from January 1 2009 and by others to switch to quarterly benchmark settlements. There is not yet a consensus to change.

We foresee 2009 as a transition year with most buyers and sellers sticking with the annual benchmark.

Other buyers and sellers may move to a mixture of index and benchmark pricing, while others will go fully to index pricing. The future appears inevitably to be moving in the direction of a full transition to index pricing.

## Rocky road to recovery

**Ralph Oppenheimer**  
Executive chairman, **Stemcor**



Last year I predicted that the financial crisis would eventually affect steel demand and that the question was not if steel prices would fall later in 2008, but when.

It is more difficult to make firm and clear predictions for 2009. No one knows for certain how long the current global depression will last.

There are many parallels between the financial crisis of 2008 and the Great Crash of 1929.

After the Great Crash, the depression continued for some time into the 1930s and some commentators are suggesting we now face a similar extended period of depression. On balance I am much more optimistic.

Just as the collapse in prices happened more quickly than ever before, we may be surprised by the speed of the world recovery.

I expect to see this starting in the USA in the second half of 2009.

I am encouraged by the recent fall in Chinese steel exports, since the new peak established in August 2008, and also by the world-wide reduction in production in response to falling demand.

I do not expect underlying demand for steel to increase in the next few months; on the contrary it will fall further.

The depletion of stocks and of forward purchase orders should nevertheless allow users of steel to return to placing orders and result in some firming of price in January.

This will be more pronounced in long products, which are heavily influenced by the price of scrap, than in flat products.

Scrap prices should continue their seasonal rise in January. The recovery of steel prices could,

however, be short lived if Chinese steel exports start to increase again in 2009.

We could see renewed price weakness in the second quarter until the world economic recovery becomes apparent some time in the second half of 2009.

## Tough times ahead and more M&A in China

**He Taiping**  
Chief of steel research, **Baosteel**

Facing challenges from a weak market and high production costs, 2009 will be a tough time for Chinese steel mills.

Following the global financial crisis, the US, Japanese, and EU economies have all entered recession, while growth in emerging economies is slowing.

China's GDP growth rate has seen a steady decline in the past five quarters since Q3 2007.

Despite the Chinese government's announcement of a more active financial policy, a more flexible currency policy, and a 4 trillion yuan (\$586 billion) stimulus package focusing on new infrastructure, it will take some time for citizens and enterprises to recover the confidence to spend and invest.

China's GDP growth in 2009 is expected to fall to around 8% and fixed asset investment could slide to around 10%.

There will be negative growth in steel demand and consumption. Chinese crude steel consumption could fall by around 8% to 411 million tonnes in 2009.

In 2008, raw material prices surged. But domestic iron ore spot prices have already declined below benchmark prices, setting the stage for a possible benchmark decrease this year.

However, it is still uncertain if Chinese mills will obtain a large decrease given the high concentration of ownership in iron ore supply and Chinese steel mills' heavy reliance on imported iron ore.

High labour and other business costs will also persist in 2009.

The steel industry is developing in a cycle of low cost/low price, low cost/high price, high cost/low price, and then back to low cost/low price.

China is at the stage of high cost and low price, which will last until the first half of next year when raw material inventories are used up. Until then, profitability will drop further; the whole industry may even go into the red.

Changes can be expected in China's steel industry. Weak demand and high production costs are serious challenges, but will create opportunities to improve the structure of industry.

Companies will upgrade their technologies and optimise their product structures, and the weak market will push companies and authorities towards M&A activity.

After the two big acquisitions by Baosteel and Wuhan Steel in 2008, there will be more acquisitions in the regions this year.

And Beijing will grant approval to more greenfield projects in coastal areas, helping to adjust the location of steel sites and substitute backward capacity.

## Iron ore prices will fall 30-40%

**Sandy Chim**  
Chairman, **Augyva Mining**

The dynamics of the sellers' market in iron ore changed after buyers turned the tables on miners at the same time as the international financial crisis hit, and as China introduced measures to curb inflation and cool the economy.

This change in demand was so sudden and so big (by 30-40% in a couple of months) that it caught the whole world by surprise.

Among the biggest casualties are the many Chinese steel mills suffering losses and who have reduced production by 20% or more.

It is estimated that 42 of the 71 largest mills, in October 2008 alone, operated at a loss totaling over \$1 billion.

This quickly brought the iron ore spot price to even below the current fob contract price.

